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No. 05-1294

IN THE

Supreme Court of the United States

MCLANE WESTERN, INC.,
Petitioner,

v.

DEPARTMENT OF REVENUE, STATE OF COLORADO, *ET AL.*,
Respondents.

On Petition for a Writ of Certiorari to the Colorado Court of Appeals, Division IV

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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RULE 29.6 CORPORATE DISCLOSURE STATEMENT

McLane Western, Inc. has set forth its Rule 29.6 corporate disclosure statement in its Petition for a Writ of Certiorari, filed April 7, 2006.

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REPLY BRIEF OF PETITIONER

Petitioner McLane Western, Inc. respectfully replies to the opposition of respondents the Colorado Department of Revenue and M. Michael Cooke, in her official capacity as Executive Director of the Colorado Department of Revenue, to petitioner's request for a Petition for a Writ of Certiorari to review the judgment of the Colorado Court of Appeals as follows:

Respondents' attempts to defend the erroneous constitutional ruling of the court below are contrary to this Court's bedrock Commerce Clause jurisprudence, and do not distinguish *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64 (1963), or *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984), both of which condemn taxing schemes functionally identical to Colorado's. Respondents do not dispute the central feature of the Colorado taxing regime that lies at the heart of this case, namely, that the State's tax base (and therefore the tax) is increased when more of the distribution chain is located outside of Colorado and decreased when more of the distribution chain is located within the State. Indeed, respondents could hardly contend otherwise, because to do so would fly in the face of the court of appeals' determination that "if the manufacturer and all the distributors were located within Colorado, the tax base would be at its lowest." Pet. App. at 6a. It is this undisputed (and indisputable) fact of an inverse relationship between tax liability and in-state economic activity that runs counter to Commerce Clause doctrine and warrants this Court's review. *See* Brief of the American Trucking Associations, Inc., *et al.*, as *Amici Curiae* in Support of Petitioner at 4-6 (analyzing flawed constitutional analysis and significant adverse impact of the court of appeals' ruling).

I. COLORADO'S DISCRIMINATORY TAX CANNOT BE DEFENDED ON THE THEORY THAT PETITIONER MIGHT HAVE AVOIDED IT

While conceding that petitioner has suffered a competitive disadvantage as a result of Colorado's discriminatory tax regime, respondents nevertheless seek to defend the tax discrimination on the ground that "the competitive disadvantage is a product of McLane's decision to purchase * * * through a distribution supply chain rather than directly from a manufacturer." Br. in Opp. at 8. According to respondents, petitioner's claim fails under the Commerce Clause because "the higher tax McLane wishes to avoid is of its own making and a product of its own * * * purchasing model" and "not Colorado's * * * tax scheme." *Id.* at 8-9.

Respondents' argument fails on two counts. First, the infirmity in Colorado's taxing scheme is not that it favors one "purchasing model" over another, but that it favors supply chains with more *in-state* links over identical supply chains with more *out-of-state* links. The court of appeals explicitly recognized this fact in observing that "the tax base will be higher the later in the distribution network the product is taxed" (Pet. App. at 6a), and that "if the manufacturer and all of the distributors were *located in Colorado*, the tax base would be at its lowest." *Ibid.* (emphasis added).[1]

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[1] Respondents' suggestion that, notwithstanding the offer of a lower tax base, Colorado's taxing regime might actually discourage manufacturers and suppliers from moving to Colorado, because they would become subject to a tax they could otherwise avoid (Br. in Opp. at 8, 10), misses the economic point. Of course they would be subject to tax, but to a lower tax than otherwise would be due from McLane if these out-of-state entities had remained outside the State. And that lower tax could be passed on to McLane who would economically benefit, as McLane no longer would be liable for the greater tax because it no longer would be the distributor first engaging in taxable activity in the State. *See* Brief of Washington Legal Foundation as *Amicus Curiae* in Support of Petitioner at 11-12 (describing

Second, the suggestion that petitioner might have avoided the discriminatory impact of Colorado's tax by restructuring its operations to purchase products at an earlier point in the distribution chain is no defense to Commerce Clause discrimination. Forcing taxpayers to choose between subjecting themselves to a discriminatory tax or rearranging their affairs to avoid the exaction plainly "forecloses tax-neutral decisions," *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 331 (1977), thereby undermining our national common market. This Court has specifically held that a victim's ability to circumvent discrimination by yielding to its illicit incentives cannot save an impermissibly discriminatory tax. *See Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin.*, 505 U.S. 71, 78 (1992) (there is "no authority" for proposition that a discriminatory tax "may be upheld if the taxpayer could avoid that discrimination by changing the [corporate] domicile").

II. THE SUPERFICIAL NEUTRALITY OF COLORADO'S TAX DOES NOT SHIELD IT FROM CONDEMNATION AS A LEVY THAT DISCRIMINATES AGAINST INTERSTATE COMMERCE

In their Opposition, respondents make much of the fact that the Colorado taxing scheme has a superficial neutrality, because it applies to the distributor who first engages in taxable activity in Colorado at whatever price the distributor paid for the product. "[D]etermining the tax base requires only ascertaining what price the distributor responsible for the * * * tax paid for OTP" (Br. in Opp. at 3); "[a]ll that matters is the price McLane paid for the OTP" (*id.* at 6); and "'[a]ll taxable distributors * * * are taxed at the same rate and on a tax base determined in the same fashion.'" *Id.* at 7

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the economic consequences of an out-of-state distributor submitting to Colorado's excise tax).

(quoting Pet. App. at 8a). But respondents (like the court below) ignore the critical underpinnings of this Court's contemporary Commerce Clause jurisprudence in suggesting that the superficial neutrality of a tax can protect it from Commerce Clause attack, when the practical effect of the levy is to discriminate against interstate commerce.

In its modern Commerce Clause opinions, this Court has repeatedly emphasized that "the Commerce Clause has a deeper meaning that may be implicated even though state provisions * * * do not allocate tax burdens between insiders and outsiders in a manner that is facially discriminatory." *American Trucking Ass'ns, Inc. v. Scheiner*, 483 U.S. 266, 281 (1987). Accordingly, the Court has embraced a decisional framework that has increasingly "considered not the formal language of the tax statute but rather its practical effect." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). Indeed, the Court has explicitly rejected respondents' "focus on * * * formalism [that] merely obscures the question whether the tax produces a forbidden effect." *Id.* at 288.

In *American Trucking Associations*, for example, the Court struck down "facially neutral," 483 U.S. at 269, flat taxes on interstate motor carriers. Like Colorado's levy at issue here, the flat taxes were superficially neutral, because the same tax applied to all trucks, whether intrastate or interstate. But the Court found that the challenged taxes necessarily disadvantaged interstate truckers, who traveled fewer miles in the State than did their intrastate competitors, because the interstate truckers paid a substantially higher effective per-mile tax. Thus the Court observed:

> Although out-of-state carriers obtain a privilege to use Pennsylvania's highways that is nominally equivalent to that which local carriers receive, imposition of the flat taxes for a privilege that is several times more valuable to a local business than to its out-of-state competitors is

> unquestionably discriminatory and thus offends the Commerce Clause.

Id. at 296.

Similarly, in *Nippert v. City of Richmond*, 327 U.S. 416, 430-35 (1946), the Court struck down a facially neutral municipal tax imposed on those engaging in business as solicitors on the ground that the tax in its "practical operation worked discriminatorily against interstate commerce." *Id.* at 425. The Court observed: "To ignore the variations in effect which follow from application of the tax, uniform on the face of the ordinance, * * * is only to ignore these practical consequences." *Id.* at 431.

In this case, respondents do not (and cannot) dispute the fact that Colorado's tax increases when more links in the distribution chain are located outside the State and decreases when more links in the distribution chain are located within the State. A clearer example of discrimination in effect would be difficult to imagine, and "[a]ctual discrimination, wherever it is found, is impermissible," *Associated Industries of Missouri v. Lohman*, 511 U.S. 641, 650 (1994), even when the statutes causing such discrimination are superficially neutral.

III. COLORADO'S EXCISE TAX DISCRIMINATION BROADLY AFFECTS COLORADO DISTRIBUTORS AND CANNOT BE DEFENDED AS A LEGITIMATE ANTIDOTE TO TAX MANIPULATION

Respondents argue that Colorado's discrimination is unworthy of review because there is "no evidence indicating" that petitioner's grievance is not a "unique situation," stemming from "an artificial supply chain" (Br. in Opp. at 13, 14) created by petitioner's supplier to produce an excise tax advantage. *Id.* at 14. On a related note, respondents urge the

Court to overlook the disparate tax burdens borne by in-state and out-of-state distribution because Colorado's "shifting tax base" is "a rational way for States to combat * * * continuing attempts to avoid or limit their state tax liabilities through creative and sometimes questionable tax planning." *Id.* at 9.

Wholly apart from the impropriety of making unfounded factual allegations without record support at this late stage of the proceedings, not to mention the questionable relevance of the alleged tax planning of petitioner's *supplier* to the discrimination visited upon *petitioner* by Colorado's taxing regime, available information shows that these allegations have no basis in fact. First, a Washington Court of Appeals opinion addressing this very same "supply chain" in the context of Washington's excise tax reveals that petitioner's supplier first learned of the excise tax consequences of the reorganization of its manufacturing and distribution operations from a state tax auditor *six years after the reorganization had occurred. United States Tobacco Sales & Mktg., Inc. v. Department of Revenue*, 982 P.2d 652, 654-55 (Wash. Ct. App. 1999). Plainly, it was something other than excise tax planning that motivated the reorganization of petitioner's supplier.

Second, in the proceedings below, respondents stipulated that the transactions between petitioner's supplier and the manufacturer were conducted at "arm's length." Br. in Opp. at 14 n.3. This concession contradicts respondents' belated characterization of the transactions at issue as "artificial."

Third, the *amicus* filing in this case by the Colorado Association of Distributors, among others, demonstrates that the discrimination suffered by petitioner does not arise from a "unique situation" involving an "artificial supply chain." The brief shows that the Colorado scheme in fact discriminates against a broad array of other Colorado distributors who acquire similar products from out-of-state distributors and are forced to pay "a higher tax than they would pay were the

tobacco products manufactured or first distributed in Colorado." *See* Brief of the Colorado Association of Distributors as *Amicus Curiae* in Support of Petitioner at 1-2.

Fourth, respondents' own Brief in Opposition refers to numerous other state excise tax statutes that employ a similar "shifting tax base." Br. in Opp. at 3 n.1. These statutes, like Colorado's, are not confined to allegedly "artificial" transactions employed to produce excise tax advantages, and their existence reinforces the significance of this case and the need for this Court's review. *See* Brief of Washington Legal Foundation as *Amicus Curiae* in Support of Petitioner at 4.

Finally, even if Colorado had a legitimate concern with excise tax manipulation, it is not free to adopt discriminatory tax measures to address that concern. The Court's cases "leave open the possibility that a State may validate a statute that discriminates against interstate commerce by showing that it advances a legitimate local purpose that cannot be adequately served by *reasonable nondiscriminatory alternatives*." *New Energy Co. v. Limbach*, 486 U.S. 269, 278 (1988) (emphasis added). There are a number of reasonable nondiscriminatory alternatives available to the State to impose an excise tax on other tobacco products while still protecting the tax from "questionable tax planning" (Br. in Opp. at 9), such as a per-unit tax, a value-based tax imposed at a single point in a distribution chain that does not vary with its location within or without the State, or a retail sales tax. *See* Pet. at 13.[2]

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[2] Respondents err in contending that the competitive disadvantage of which petitioner complains "arises in the context of * * * the sales and use tax" (Br. in Opp. at 9), because the typical sales and use tax differs in a dispositive respect from Colorado's excise tax. The sales tax is always imposed upon the final sales price to the consumer, and thus even-handedly captures each middleman's markup, regardless of whether those middlemen are located within or without the State. Contrary to respondents' assertions, petitioner is not objecting to the taxation of the

IV. RESPONDENTS' EFFORTS TO DISTINGUISH *HALLIBURTON* AND *ARMCO* ELEVATE FORM OVER SUBSTANCE

Respondents' efforts to distinguish *Halliburton* and *Armco* elevate form over substance and ignore the teachings of this Court's Commerce Clause jurisprudence.

A. The Facts Of *Halliburton* Are In Substance Identical To The Facts Of This Case

To avoid the controlling force of *Halliburton*, respondents offer two hypothetical scenarios upon which they rely to distinguish the facts of this case from those of *Halliburton*. Br. in Opp. at 10-11. Respondents then claim that these differences somehow demonstrate that Colorado's statute passes muster. *Ibid.* Wholly apart from the point that the argument rests on a *non sequitur*—because some other hypothetical tax scheme violates the Commerce Clause, this one does not—the hypotheticals offered by respondents are in substance no different from the facts of this case and reaffirm the discriminatory nature of the Colorado scheme.

Respondents claim that "the facts in *Halliburton* would have to be adjusted" in a number of ways "for it to be the twin of the case at hand." *Id.* at 10. But the only facts to which respondents point either are *identical* to the facts of this case or have nothing to do with the substance of the operation of the statutes in the two cases. Thus respondents contend that "Louisiana would have to have had a consistent tax rate based on the price paid for goods brought from outside the state for sale in Louisiana." *Ibid.* In fact, Louisiana *did* have a consistent tax rate—two percent—for such goods. *See* Pet. at 11. Respondents further claim that to make

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"marked-up price." *Ibid.* Petitioner is objecting to a tax imposed on the markup only when the "middleman" is located out of State. And it is that mechanism which violates the Commerce Clause.

this case the "twin" of *Halliburton*, the taxpayer in *Halliburton* would have had to claim tax liability based on the price paid under exclusive contracts by some other entity who was affiliated with the entity from which the taxpayer bought the goods. Br. in Opp. at 10-11. But these are matters of form that have nothing to do with the constitutional infirmity in this case or in *Halliburton*, to wit, that the tax base increased in *Halliburton* because assembly activity occurred outside Louisiana, just as the tax base increased in the instant case because the distribution activity occurred outside Colorado. Similarly, the second hypothetical offered by respondents, where they *concede* that discrimination exists (*id.* at 11), focuses largely on matters of form that would simply make the discrimination that exists in this case more transparent.

In the end, respondents' attempt to deflect the Court's attention from the clear application of *Halliburton* to this case turns entirely on their unjustifiably narrow focus on the superficially neutral form of the Colorado statute. Respondents never advance their argument beyond repetition of the mantra of the court below that "'[a]ll taxable distributors * * * are taxed at the same rate and on a tax base determined in the same fashion.'" Br. in Opp. at 7, 11 (quoting Pet. App. at 8a). For the reasons set forth above, such a preoccupation with the form of the tax while ignoring its substance has no place in the Court's contemporary Commerce Clause jurisprudence and would undermine the Court's holding in *Halliburton*.

B. The Facts Of *Armco* Are In Substance Identical To The Facts Of This Case

Respondents' perfunctory effort to distinguish *Armco* is also unsuccessful. Br. in Opp. at 12. Respondents focus entirely on the *form* of the discrimination at issue while ignoring its *substance*. Thus respondents contend that the discrimination at issue in *Armco* is distinguishable from the

discrimination at issue in the instant case because there is no formal exemption in the Colorado statute (as there was in the statute in *Armco*) for those engaged in in-state activity.

But for the reasons set forth above and in the Petition (*see* Pet. at 17-18), this is a distinction without a constitutional difference. It is the "practical or economic effect of the tax[,]" *Goldberg v. Sweet*, 488 U.S. 252, 262 (1989), not "formal distinctions that lack economic substance[,]" *Westinghouse Electric Co. v. Tully*, 466 U.S. 388, 405 (1984), which is the touchstone of Commerce Clause analysis. The favoritism for in-state manufacturers/wholesalers under West Virginia's taxing scheme in *Armco* is economically indistinguishable from the favoritism for in-state manufacturers/distributors under Colorado's taxing scheme here. Both violate settled Commerce Clause doctrine articulated by this Court.

CONCLUSION

For the foregoing reasons and the reasons raised in the Petition for a Writ of Certiorari, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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